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CLERK U.S. DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

IN RE STEC, INC. SECURITIES) No. SACV 09-01304-JVS (MLGx)
LITIGATION)
) **CONSOLIDATED AMENDED**
) **COMPLAINT FOR VIOLATION**
) **OF THE FEDERAL**
This Document Relates To:) **SECURITIES LAWS**
)
) **CLASS ACTION**
)
ALL ACTIONS) **DEMAND FOR JURY TRIAL**
) Judge: Hon. James V. Selna
)
)
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1 Court appointed Lead Plaintiff, the State of New Jersey, Department of
2 Treasury, Division of Investment ("Lead Plaintiff"), individually and on behalf of a
3 class of similarly situated persons and entities, by its undersigned counsel, for its
4 Consolidated Amended Class Action Complaint for Violation of the Federal
5 Securities Laws asserting claims against STEC, Inc. ("STEC" or the "Company")
6 and the other Defendants named herein, alleges the following upon personal
7 knowledge as to itself and its own acts, and upon information and belief as to all
8 other matters.

9 Lead Plaintiff's information and belief as to allegations concerning matters
10 other than itself and its own acts is based upon an investigation by its counsel
11 which included, among other things: (i) review and analysis of documents filed
12 publicly by STEC with the Securities and Exchange Commission (the "SEC"); (ii)
13 review and analysis of press releases, news articles, and other public statements
14 issued by or concerning STEC and other Defendants named herein; (iii) review and
15 analysis of research reports issued by financial analysts concerning STEC's
16 securities and business; (iv) interviews of former STEC employees; (v) interviews
17 of employees and former employees of computer manufacturing companies; and
18 (vi) review and analysis of news articles, media reports and other publications
19 concerning the computer industry. Lead Plaintiff believes that substantial
20 additional evidentiary support for the allegations herein exists and will continue to
21 be revealed after Lead Plaintiff has a reasonable opportunity for discovery.

22 **I. NATURE AND SUMMARY OF THE ACTION**

23 1. This is a class action on behalf of all persons who purchased or
24 otherwise acquired STEC common stock between June 16, 2009, and February 23,
25 2010, inclusive (the "Class Period"), seeking to pursue remedies under the
26 Securities Exchange Act of 1934 (the "Exchange Act"), and the Securities Act of
27 1933 (the "Securities Act").
28

1 2. STEC is a manufacturer of data storage technologies and solutions for
2 high-performance computer equipment made by companies such as IBM, Dell,
3 Hewlett-Packard and EMC. The Company claims to manufacture the industry's
4 most comprehensive line of solid-state drive ("SSD") memory technologies. Its
5 flagship product, the ZeusIOPS SSD, is a high-performance, flash SSD advertised
6 by the Company as being able to access stored data at much faster speeds than
7 traditional hard drives with moving parts.

8 3. The Company was founded by the Moshayedi brothers – Manouch,
9 Mehrdad ("Mark") and Masoud ("Mike") Moshayedi in 1989. The Moshayedi
10 brothers have been longtime STEC officers and directors. Manouch Moshayedi is
11 STEC's Chief Executive Officer ("CEO") and Chairman of the Company's Board
12 of Directors. Mark Moshayedi is the Company's President, Chief Operating
13 Officer ("COO"), Chief Technical Officer ("CTO") and Secretary, as well as a
14 member of STEC's Board of Directors and Equity Awards Committee. Mike
15 Moshayedi, who retired in 2007, but retained at that time an 8.99% ownership
16 interest in the company, was formerly the Company's President.

17 4. The Moshayedi brothers are also major shareholders of the Company.
18 At the beginning of the Class Period they collectively held 45% of the Company's
19 stock.

20 5. As detailed herein, during the Class Period, Defendants issued or
21 caused to be issued materially untrue statements and omissions as to STEC's
22 financial performance and condition. These statements created a materially false
23 impression of STEC's business and financial condition, by, among other things,
24 creating a false impression of exceptional revenue growth, and of conditions that
25 ensured a near and long term continuation and even acceleration of this growth.

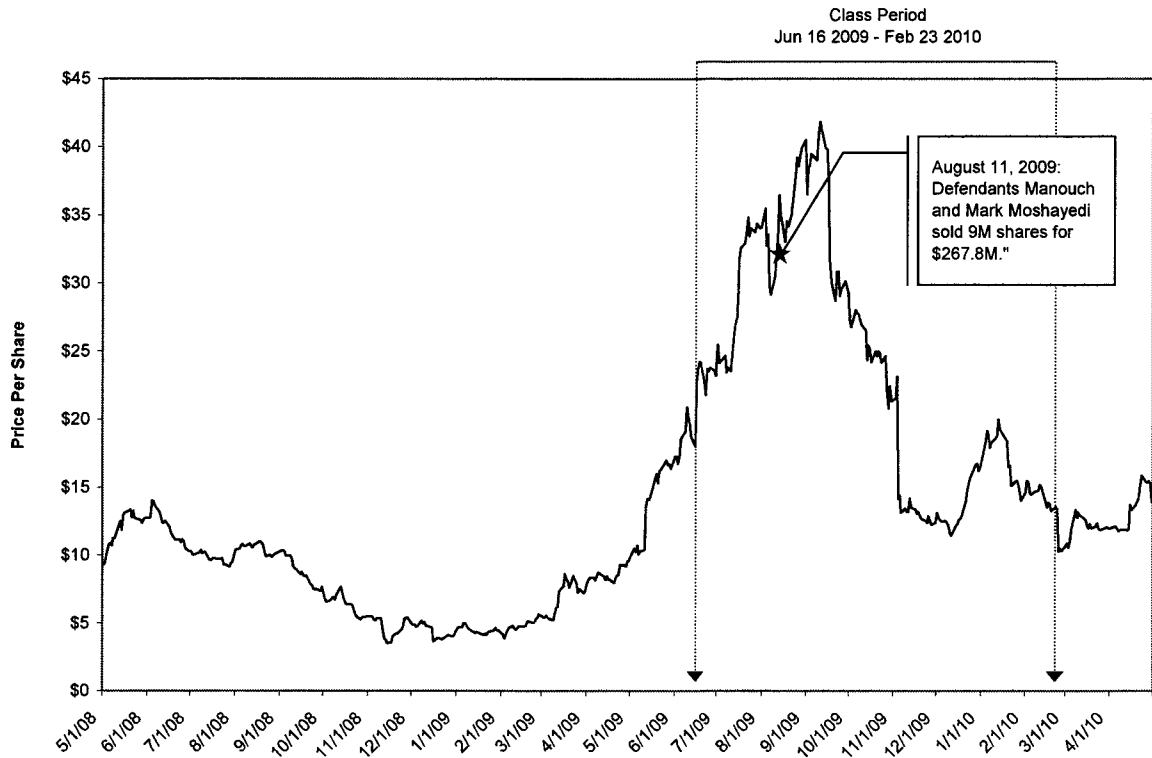
26 6. In summary form, these materially untrue statements and omissions
27 included:
28

- 1 (a) that a new agreement signed by STEC with its largest customer
2 for a huge volume of purchases, satisfied that customer's
3 requirements for a period of only six months—the second half of
4 2009—and represented a new, heightened level of purchases by
5 that customer that would be repeated, essentially, every six
6 months;
- 7 (b) that during the second half of 2009, STEC's four other large
8 customers would be making similar agreements to increase the
9 volume of their own purchases to a similar extent;
- 10 (c) that, after STEC's revenue grew substantially during the first
11 quarter of 2009, it would grow—and then did grow—during the
12 second quarter of 2009 at a rate even faster than it had grown
13 during the first quarter of 2009; and
- 14 (d) that STEC had no competition for its signature product, called
15 ZeusIOPS.

16 7. The initial effect of these false statements and omissions was to
17 dramatically inflate the price of STEC's stock. As indicated in the chart below, the
18 second quarter of 2009 marked a tremendous growth spurt in the price of STEC
19 stock, buoyed by the Company's public statements about increasing sales and
20 revenues.

21 8. Indeed, as illustrated by the below chart, by August 3, 2009, STEC
22 stock had enjoyed a 900% increase over its price just eight months earlier in
23 December 2008. However, during the subsequent five months, when the falsity of
24 these statements and omissions was disclosed by several successive partial
25 disclosures, the price of STEC's stock collapsed all the way back to where it had
26 been before the start of the Class Period.

27
28



9. After the initial inflation of STEC's stock price, and just prior to the subsequent collapse, when the false impression created by Defendants' misstatements and omissions was at its most intense, and the resulting rise in the price of STEC's stock was nearing its high point, STEC issued a secondary offering of stock, comprised entirely of stock held personally by Manouch and Mark Moshayedi, the Company's CEO and COO. These two defendants, who are brothers, sold more than 50% of their STEC stock in the offering, and received thereby, a total of \$267.8 million.

10. Five months later, as the price of STEC's stock was hitting a new low, STEC announced that certain of its employees, including its CEO, had been subpoenaed by the SEC, as part of a formal investigation by the SEC of STEC's stock sales.

11. Under Counts I through III, which Lead Plaintiff brings under the Exchange Act, and only under such counts, Lead Plaintiff alleges that STEC and each of the Individual Defendants committed fraud, by making some or all of the

1 alleged materially untrue statements and/or omissions with knowledge—or
2 reckless disregard—of their falsity, and that three of the Individual Defendants are
3 liable as control persons.

4 12. Under Counts IV through VI, which Lead Plaintiff brings under the
5 Securities Act, Lead Plaintiff alleges that each defendant is liable for his/its
6 negligence regarding the untrue statements and omissions to the extent that they
7 were made or incorporated into the registration statement and/or prospectus for the
8 secondary offering, and that three of the Individual Defendants are also liable as
9 control persons. Lead Plaintiff does not allege fraud as to any of its claims under
10 the Securities Act.

11 **II. JURISDICTION AND VENUE**

12 13. The claims asserted herein arise under and pursuant to Sections 11,
13 12(a)2, and 15 of the Securities Act, 15 U.S.C. §§ 77k(a), 77l(a), 77o, Sections
14 10(b), 20(a), and 20A of the Exchange Act, 15 U.S.C. §§ 78j(b), 78t(a), 78-t1(a)
15 and Rule 10b-5 promulgated under Section 10 of the Exchange Act, 17 C.F.R. §
16 240.10b-5, and 15 U.S.C. § 78r.

17 14. This Court has jurisdiction over the subject matter of this action
18 pursuant to Section 22 of the Securities Act, 15 U.S.C. § 77v, Section 27 of the
19 Exchange Act, 15 U.S.C. § 78aa, and 28 U.S.C. §§ 1331, 1367.

20 15. Venue is proper in this District pursuant to Section 22 of the
21 Securities Act, Section 27 of the Exchange Act, 15 U.S.C. § 78aa, and 28 U.S.C. §
22 1391(b). Defendant STEC maintains its principal place of business within this
23 District, the Individual Defendants conduct business in this District, and many of
24 the acts giving rise to the violations alleged herein, including the preparation and
25 dissemination of materially false and misleading information and omissions,
26 occurred in substantial part in this District.

27 16. In connection with the acts alleged herein, Defendants, directly or
28 indirectly, used the means and instrumentalities of interstate commerce including,

1 without limitation, the United States mail, interstate telephone communications and
2 the facilities of the national securities markets.

3 **III. THE PARTIES**

4 **A. The Plaintiffs**

5 17. The State of New Jersey, through its Division of Investment, is a large
6 institutional investor, managing in excess of \$75 billion for the benefit of over
7 600,000 current and former public employees of the State of New Jersey. Lead
8 Plaintiff purchased STEC common stock during the Class Period and suffered
9 losses as a direct or proximate result of Defendants' wrongful conduct alleged
10 herein. On July 14, 2010, the Court appointed New Jersey as Lead Plaintiff and
11 gave New Jersey leave to file a Consolidated Amended Complaint if it chose to do
12 so.

13 18. Representative Plaintiff the International Brotherhood of Electrical
14 Workers, Local 103 ("Local 103"), located in Dorchester, Massachusetts, oversees
15 the Electrical Workers Pension Fund, with assets of approximately \$913 million.
16 Local 103 alleges violations of Section 20A of the Exchange Act on behalf of itself
17 and all Class members who purchased STEC securities contemporaneously with
18 Defendants Manouch and Mark Moshayedi's sales of STEC stock during the Class
19 Period. As set forth in the certification annexed hereto as Exhibit A,
20 Representative Plaintiff Local 103 purchased STEC securities contemporaneously
21 with the sales of STEC securities by Manouch and Mark Moshayedi and suffered
22 damage as a result of the misconduct alleged herein.

23 19. Representative Plaintiff The Norfolk County Retirement System
24 ("Norfolk County"), located in Massachusetts, has more than 9,500 active and
25 retired members from forty governmental units throughout the County of Norfolk,
26 Massachusetts, and has approximately \$480 million in assets. Norfolk County
27 alleges violations of Sections 11, 12(a)(2) and 15 of the Securities Act on behalf of
28 itself and all Class members who acquired shares of STEC common stock pursuant

1 to or traceable to the registration statement (the “Registration Statement”) and/or
2 the prospectuses (the “Prospectus”) issued in connection with the Offering.
3 Norfolk County purchased shares of STEC stock on the Offering. As set forth in
4 the certification annexed hereto as Exhibit B, Representative Plaintiff Norfolk
5 County purchased STEC securities pursuant to or traceable to the Registration
6 Statement and/or Prospectus and suffered damages as a result of the false
7 statements contained therein.

8 **B. The Issuer Defendant**

9 20. Defendant STEC is a California corporation with its principal place of
10 business located at 3001 Daimler Street, Santa Ana, California. STEC purports to
11 be a leading global provider of solid-state computer memory drive technologies
12 and solutions tailored to meet the high-performance, high-reliability needs of
13 original equipment manufacturers (“OEMs”) like Sun Microsystems, EMC, IBM,
14 and Dell. During the Class Period, STEC’s core business was its enterprise scale
15 SSDs, such as the ZeusIOPS. STEC claims to manufacture the industry’s “most
16 comprehensive line” of SSDs in the storage industry.

17 21. Defendants Manouch Moshayedi and his brothers, Mark and Mike
18 Moshayedi founded STEC, then named Simple Technology, Inc. (“SimpleTech”),
19 in 1990. Simple Tech sold memory products for PCs, printers and servers.

20 22. The Company grew rapidly through acquisitions and expansions both
21 domestically and abroad. Eventually the Company opened locations in Italy,
22 Japan, China and Taiwan. In 2007, the Company’s Malaysian facility was opened
23 with complete design, manufacturing and logistics capabilities.

24 23. The Company went public in September 2000.

25 24. In 2007, STEC introduced its high-end, flagship product, the
26 ZeusIOPS.

27 25. Throughout the Class Period (June 16, 2009 through February 23,
28 2010), the Company’s stock traded in an efficient market on NASDAQ under the

1 ticker symbol, "STEC." As of March 30, 2010, the Company had nearly 51
2 million shares of common stock outstanding.

3 **C. The Individual Defendants**

4 26. At all relevant times Defendant Manouch Moshayedi has been CEO,
5 Chairman of STEC's Board of Directors and a member of the Equity Awards
6 Committee. During the Class Period, Manouch Moshayedi signed and certified
7 STEC's SEC filings pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act
8 of 2002, including, without limitation, the Company's quarterly report for the
9 second quarter of 2009 ("2Q09 Form 10-Q") and the annual report for 2009 ("2009
10 Form 10-K"). He also signed the documents in connection with the Offering
11 including the Registration Statement on Form S-3 ("Registration Statement"), and
12 the Prospectus contained in the Registration Statement. Manouch Moshayedi sold
13 4.5 million shares of his STEC common stock for \$133,920,000 in the Offering.

14 27. At all relevant times Defendant Mark Moshayedi, has been STEC's
15 President, COO, CTO, and Secretary, as well as a member of the Company's
16 Board of Directors and a member of the Equity Awards Committee. During the
17 Class Period, Mark Moshayedi signed STEC's SEC filings, including, without
18 limitation, the Registration Statement, and the 2009 Form 10-K. Mark Moshayedi
19 sold 4.5 million shares of his STEC common stock for \$133,920,000 in the
20 Offering.

21 28. At all relevant times Defendant Raymond D. Cook has been STEC's
22 Chief Financial Officer, ("CFO") and Principal Accounting Officer. During the
23 Class Period, Defendant Cook signed STEC's SEC filings including the
24 Registration Statement, the 2Q09 Form 10-Q and the 2009 Form 10-K.

25 29. Because of their positions with the Company, Defendants Manouch
26 Moshayedi, Mark Moshayedi, and Raymond D. Cook (collectively, the "Individual
27 Defendants") possessed the power and authority to control the contents of STEC's
28 quarterly reports, press releases, and presentations to securities analysts, money

1 and portfolio managers, and institutional investors. They were provided with
2 copies of the Company's reports and press releases alleged to be misleading prior
3 to or shortly after their issuance, and had the ability and opportunity to prevent
4 their issuance or cause them to be corrected. Because of their positions with the
5 Company, and their access to material non-public information, the Individual
6 Defendants knew, or with deliberate recklessness disregarded, that the adverse
7 facts specified herein were being concealed from the public, and that the positive
8 representations being made were then materially false and misleading.

9 30. As officers and controlling persons of a publicly-held company whose
10 common stock was, and is, registered with the SEC pursuant to the Exchange Act,
11 traded on NASDAQ, and governed by the provisions of the federal securities laws,
12 the Individual Defendants each had a duty promptly to disseminate accurate and
13 truthful information with respect to the Company's financial condition and
14 performance, growth, operations, financial statements, business, products, markets,
15 management, earnings, and present and future business prospects, and to correct
16 any previously-issued statements that had become materially misleading or untrue,
17 so that the market price of the Company's publicly traded common stock would be
18 based on truthful and accurate information. The Individual Defendants'
19 misrepresentations and omissions during the Class Period violated these specific
20 requirements and obligations. The Individual Defendants are therefore liable for
21 the false and misleading statements pleaded herein. (The Company and the
22 Individual Defendants are collectively referred to as the "Exchange Act
23 Defendants.")

24 **D. The Director Defendant**

25 31. Rajat Bahri was, at all relevant times, a member of STEC's Board of
26 Directors, and Chair of the Board's Audit Committee. During the Class Period,
27 Defendant Bahri signed the Company's SEC filings, including, without limitation,
28 the Registration Statement and the 2009 Form 10-K.

1 32. STEC's Board of Directors has determined that Mr. Bahri is an "audit
2 committee financial expert," as that term is defined in Item 407(d)(5) of Regulation
3 S-K, which means that the Company's Board determined that Defendant Bahri has
4 the following attributes:

5 (a) An understanding of generally accepted accounting principles
6 and financial statements;

7 (b) The ability to assess the general application of such principles
8 in connection with the accounting for estimates, accruals and reserves;

9 (c) Experience preparing, auditing, analyzing or evaluating
10 financial statements that present a breadth and level of complexity of accounting
11 issues that are generally comparable to the breadth and complexity of issues that
12 can reasonably be expected to be raised by the registrant's financial statements, or
13 experience actively supervising one or more persons engaged in such activities;

14 (d) An understanding of internal control over financial reporting;
15 and

16 (e) An understanding of audit committee functions.

17 33. Because of Defendant Bahri's positions with the Company, he was
18 aware of undisclosed material adverse information about STEC's business,
19 finances, markets and business prospects, via access to internal corporate
20 documents, conversations and interactions with STEC corporate officers and
21 employees.

22 **E. The Underwriter Defendants**

23 34. Defendant Barclays Capital Inc. ("Barclays Capital") is an investment
24 bank that acted as an underwriter with respect to STEC common stock sold in the
25 Offering. Barclays Capital's headquarters are located at 745 Seventh Avenue,
26 New York, New York 10019.

27 35. Defendant Deutsche Bank Securities Inc. ("Deutsche Bank
28 Securities") is an investment bank that acted as an underwriter with respect to

1 STEC common stock sold in the Offering. Deutsche Bank Securities' headquarters
2 are located at 60 Wall Street, New York, New York 10005.

3 36. Defendant J.P. Morgan Securities Inc. ("J.P. Morgan Securities") is an
4 investment bank that acted as an underwriter with respect to STEC common stock
5 sold in the Offering. J.P. Morgan Securities' headquarters are located at 277 Park
6 Avenue, New York, New York 10172.

7 37. Defendant Oppenheimer & Co., Inc. ("Oppenheimer") is an
8 investment bank that acted as an underwriter with respect to STEC common stock
9 sold in the Offering. Oppenheimer's headquarters are located at 125 Broad Street,
10 New York, New York 10004.

11 38. The Underwriter Defendants acted as Underwriters of the Offering
12 and distributed at least nine million shares of STEC common stock to investors.
13 The distribution of shares to the Underwriters (excluding the 1,350,000 share over-
14 subscription allotment) was:

<u>Name</u>	<u>Number of shares</u>
J.P. Morgan Securities	2,925,000
Deutsche Bank Securities	2,925,000
Barclays Capital	1,800,000
Oppenheimer	1,350,000

19 39. In connection with the Offering, the Underwriter Defendants were
20 granted an option for a period of 30 days to purchase up to an additional 1,350,000
21 shares to cover overallotments.

22 40. The Underwriter Defendants received an underwriting discount of at
23 least \$11.16 million, indirectly paid by Lead Plaintiff and other Class members
24 who purchased STEC common stock in the Offering.

25 41. The Underwriter Defendants failed to conduct an adequate due
26 diligence investigation, which was a substantial contributing factor leading to the
27 harm complained of herein.

28

1 **IV. CONFIDENTIAL WITNESSES**

2 42. The allegations herein are supported in part by information provided
3 to date by eleven confidential witnesses, including former STEC employees and
4 employees of STEC's customers. As described below, the confidential witnesses
5 have provided information about the Company and its management that may be
6 adverse to Defendants in this litigation. Accordingly, the confidential witnesses
7 have not been identified by name, but rather by job title and date in order to protect
8 the confidential witnesses against retaliation and career injury. As described
9 below, each of the confidential witnesses, because of his or her employment
10 position and tenure, was in a position to know, and in fact knew, about the
11 information they provided that is alleged herein.

12 (a) Confidential Witness 1 ("CW1") was employed at STEC from
13 June 2004 through July 2009. She worked as a Sales Coordinator for STEC's sales
14 to Hewlett-Packard ("HP"). CW1 assisted STEC's Vice Presidents of Sales who
15 dealt with sales of STEC memory products to HP. CW1's duties included
16 obtaining and pricing purchase orders, coordinating sales calls and meetings, and
17 assisting with delivery issues and timing of shipments. CW1 reported to Steve
18 McCarthy until 2008, when she began reporting to Lorenzo Salhi. Both McCarthy
19 and Salhi reported directly to STEC's CEO, Manouch Moshayedi. CW1
20 described her experiences at STEC relating to STEC's sales practices.

21 (b) Confidential Witness 2 ("CW2") worked as a Hardware Design
22 Engineer for STEC from October 2009 through May, 2010. CW2 described
23 problems, including "power issues" with the ZeusIOPS, and that EMC returned
24 many ZeusIOPS units because of those "power issues."

25 (c) Confidential Witness 3 ("CW3") was employed by HP as a
26 Principal Hardware/Firmware Test Engineer from September 2007 through
27 September 2009. CW3 also worked as a Failure Analysis and Qualification
28

1 Engineer for SSDs including the ZeusIOPS. CW3 had daily meetings with STEC
2 engineers.

3 (d) Confidential Witness 4 ("CW4") was employed by Sun
4 Microsystems from 1999 to June 2009 as Sun Microsystems' Chief Technologist
5 of Storage and Data Management. Sun Microsystems was one of STEC's largest
6 customers. CW4 was later employed by Pliant Technologies, one of STEC's
7 customers. CW4 provided information about quality problems with ZeusIOPS
8 product, STEC's communications about product re-orders, and industry knowledge
9 about sales by EMC of ZeusIOPS Units.

10 (e) Confidential Witness 5 ("CW5") worked for STEC from
11 February 2006 through July 2009. He was the Company's Regional Sales
12 Manager for the San Francisco Bay Area and Pacific Northwest. He reported to
13 Mike Nilsson, STEC's Worldwide Vice President of Sales. CW5 described the
14 close relationship between EMC and STEC, as well as Mark and Manouch
15 Moshayedi's personal involvement in STEC's sales to EMC.

16 (f) Confidential Witness 6 ("CW6") worked as a Product Test
17 Engineer in STEC's main facility in Santa Ana, California from February 2005
18 through December 2008. CW6 detailed his experiences at STEC relating to the
19 large number of ZeusIOPS products that EMC returned to STEC and the practice
20 of shipping customers used, dysfunctional or defective product.

21 (g) Confidential Witness 7 ("CW7") worked for STEC from June
22 2002 through October 2008. CW7 was a Product Marketing Specialist for STEC
23 (with a focus on marketing DRAM and Compact Flash products). CW7 provided
24 information about Defendants Manouch and Mark Moshayedi's direct and personal
25 involvement in business dealings with EMC.

26 (h) Confidential Witness 8 ("CW8") worked at STEC as a Cisco
27 Program Manager from January 2007 until March 2009. CW8's responsibilities
28

1 included managing the manufacture, sale and distribution of flash and DRAM
2 modules to Cisco. CW8 described STEC's sales practices .

3 (i) Confidential Witness 9 ("CW9") worked at STEC as a
4 Manufacturing Maintenance Mechanic Technician from October 2006 through
5 March 2009. CW9 explained that customers returned ZeusIOPS units due to a
6 defect in the capacitor that caused overheating and burning.

7 (j) Confidential Witness 10 ("CW10") worked at STEC as a Sales
8 and Field Applications Engineer from September 2007 through November 2009.
9 CW10 confirmed that STEC's practice of shipping empty boxes to customers,
10 known as "shipping bricks."

11 (k) Confidential Witness 11 ("CW11") worked at STEC as a
12 Failure Analysis Technician from November 2007 through November 2008.
13 CW11 was responsible for analyzing failed products returned to STEC by its
14 customers and documenting his findings in reports. CW11 described his
15 experiences at STEC relating to the shipment of defective product .

16 **V. FACTUAL BACKGROUND AND SUBSTANTIVE ALLEGATIONS**
17 **RELATING TO THE EXCHANGE ACT CLAIMS**

18 **A. The Exchange Act Defendants Inflate Earnings Guidance For The**
19 **Second Quarter Of 2009, Citing Purportedly Increasing Sales Of**
20 **ZeusIOPS**

21 43. Before the market opened on June 16, 2009 (the beginning of the
22 Class Period), the Exchange Act Defendants issued a press release announcing
23 increased revenue guidance for the second quarter of 2009. First quarter revenue
24 had been \$63.5 million, previous guidance for the second quarter was \$68-70
25 million, and the increased guidance was for revenue of \$82-84 million. The press
26 release asserted that the increased revenues are "*primarily the result of increases*
27
28

1 *in the Company's ZeusIOPS sales which now are estimated to exceed \$55 million*
2 *during the second quarter of 2009.*"¹

3 44. On STEC's June 16 announcement, the price of the Company's stock
4 increased 27% in a single day to close at \$22.88 per share, a \$4.86 increase from
5 the prior day's closing price of \$18.02, on extraordinarily high trading volume of
6 10.4 million shares. At the time, STEC's stock price represented an all-time high.

7 45. Contrary to the June 16 announcement, revenues from ZeusIOPS
8 sales were not increasing so as to justify the increased guidance. For the same
9 reasons, explained, *infra*, showing that the revenue subsequently reported for the
10 second quarter of 2009 was misleadingly inflated by Defendants, so too this
11 revenue guidance was inflated, and, therefore, false.

12 **B. At The Close Of The 2009 Second Quarter, The Exchange Act**
13 **Defendants Make Misrepresentations And Misleading Omissions**
14 **Regarding A New Supply Agreement With EMC, STEC's Largest**
15 **Customer For The ZeusIOPS Product**

16 **1. The Exchange Act Defendants Assert, Essentially, That The**
17 **EMC Supply Agreement Covers EMC's Requirements For**
18 **Only The Second Half Of 2009, And, That EMC Will Be**
19 **Making Similar Purchases Every Six Months**

20 46. On July 16, 2009, just one month after increasing STEC's revenue
21 guidance for the second quarter of 2009, STEC issued a press release announcing
22 an agreement with "one of its largest enterprise storage customers"—later revealed
23 to be EMC—to purchase \$120 million worth of ZeusIOPS SSDs "*in the second*
24 *half of 2009,*" and forecasting that this would result in total ZeusIOPS sales during
25 the second half of 2009 increasing to more than \$220 million.

26
27
28 ¹ Unless otherwise noted, all emphasis is added.

1 47. EMC's purchase of \$120 million of ZeusIOPS product under the
2 EMC Supply Agreement was a purchase more than *three times as large* as EMC's
3 total purchases from STEC *during the entire preceding year*—as shown by
4 information in STEC's 2008 10-K.

5 48. The press release suggested that the huge size of the purchase resulted
6 not from any extraordinary terms of purchase and sale, but, rather, from the
7 asserted fact that "sales of [EMC's] enterprise storage systems utilizing our
8 ZeusIOPS drives *have grown significantly*."

9 49. Following STEC's July 16 assertions regarding the EMC Supply
10 Agreement, the price of STEC stock rose another 15.2%, or \$4.20 per share in a
11 single day, over the previous day's closing price, to close at \$31.79 per share on
12 July 16, 2009, on extraordinarily high trading volume. STEC's stock price thus
13 reached another all-time high.

14 50. On August 3, 2009, in STEC's second quarter earnings release, the
15 Exchange Act Defendants implied that the EMC Supply Agreement covered
16 EMC's requirements for just the second half of 2009, describing it as "the \$120
17 million supply agreement that we signed *for the second half of 2009*."

18 51. Also on August 3, 2009, during STEC's second quarter earnings
19 conference call, the Exchange Act Defendants asserted that the difference between
20 the size of the EMC Supply Agreement and the size of previous purchases of
21 ZeusIOPS by EMC and other OEM customers was that, the previous level of
22 purchases was only sufficient to support the assembly of mere samples of OEM
23 products incorporating ZeusIOPS, whereas the EMC Supply Agreement
24 represented the quantity of purchases necessary to support actual "production" of
25 such OEM products for the market. Thus, Defendant Manouch Moshayedi stated,
26 "right now," ZeusIOPS sales were based on "one customer *in production*, four
27 customers are still in pre-production, type of stage So I think once [the
28

1 pre-production customers] start kicking in, we will see huge ramps in sales of
2 ZeusIOPS *going forward*.”

3 52. Also on August 3, 2009, in its Form 424B3 filed as part of its
4 secondary offering, STEC stated that “we expect sales to EMC will represent a
5 significant percentage of our total revenues *for the foreseeable future*.”

6 53. On August 28, 2009, reflecting investors’ understanding that the \$120
7 million contract represented a new level of on-going purchases by STEC’s primary
8 ZeusIOPS customer to be made every six months, Needham published an analyst
9 report stating that “looking forward, we see a high likelihood of a *follow-on*
10 *contract order* with at least STEC’s top OEM customer in 1H10 getting signed
11 within the next 3 months.”

12 54. However, contrary to the impression STEC had created that the \$120
13 million EMC Supply Agreement was intended to cover EMC’s needs for only the
14 second half of 2009, in the Company’s November 3, 2009 earnings release for the
15 third quarter, STEC disclosed that “[EMC] might carry inventory of our ZeusIOPS
16 at the end of 2009 which they will use in 2010.”

17 55. Moreover, contrary to the impression that STEC had created on July
18 12 and August 3, that the EMC Supply Agreement represented a new, higher level
19 of ongoing purchases by EMC, Manouch Moshayedi admitted during the
20 November 3, 2009, conference call that it was “a one-off type of a deal,” while
21 now asserting that STEC felt no need to duplicate it with EMC or anyone else.

22 56. Still further, on February 23, 2010, in its earnings release for the 2009
23 fourth quarter and full year, the Exchange Act Defendants stated, “[W]e now
24 anticipate this inventory carryover to continue to negatively impact our sales to this
25 customer during the first half of 2010, as we do not expect any meaningful
26 production orders from this customer during that time.”

27 57. An indication of the way in which investors had been misled is
28 provided by the February 24, 2010, analyst report published by Oppenheimer,

1 which stated, “Now that *EMC’s supply contract with STEC for \$120M is*
2 *indicative of a full-year run rate vs. half year*, we are resetting our ‘10E EPS . . .
3 and dropping our PT”

4 58. Multiple mutually reinforcing pieces of evidence create a strong
5 inference that on July 12, 2009, when STEC announced the EMC Supply
6 Agreement, and on August 3, 2009, when STEC discussed the EMC Supply
7 Agreement with analysts, the Exchange Act Defendants already knew that the
8 \$120 million contract was an exceptional one time purchase, and *not* indicative of
9 a new ongoing level of demand for STEC’s ZeusIOPS product from EMC.

10 59. First, EMC, which had *never* publicly stated that the EMC Supply
11 Agreement covered its requirements only for the second half of 2009, subsequently
12 explained, during its January 26, 2010 earnings conference call, that the EMC
13 Supply Agreement “was *designed* to protect ourselves *going into first quarter*
14 against what we knew would be a tight supply environment.”

15 60. Second, by the end of the second quarter of 2009, STEC knew the size
16 of EMC’s requirements, because STEC had been, in Manouch Moshayedi’s own
17 phrase, a “partner” with EMC, since as early as January 14, 2008, when a STEC
18 press release announced that EMC had chosen the ZeusIOPS line of SSD’s for
19 “deployment” in its high end storage systems. As an analyst observed during the
20 November 3, 2009, earnings conference call without being contradicted by
21 Defendants, STEC had its own engineers “co-located with EMC.”

22 61. Third, although, on August 3, 2009, STEC had announced that the
23 EMC Supply Agreement was “for the second half of 2009,” and although three
24 months later, during the November 3, 2009, third quarter earnings conference call,
25 Manouch Moshayedi disclosed that, up to that point, STEC still had shipped only
26 \$55 million of the \$120 million order to EMC, nevertheless, during the same
27 November 3, 2009, conference call, STEC already announced that, in 2010, EMC
28 would still have inventory on hand from the \$120 million purchase. This

1 disclosure that EMC's order would cover its requirements not only for the second
2 half of 2009, but also, well into 2010 was timed very conveniently by Defendants
3 to follow rather than precede, not only the initial, misleading explanation of the
4 EMC Supply Agreement, but also, the Moshayedi brother's sale of nine million of
5 their own personal shares of STEC, for \$268.7 million.

6 62. Fourth, at the time when STEC and EMC had signed the EMC Supply
7 Agreement, if STEC and its senior officers had really believed that EMC was now
8 generating \$120 million of demand for ZeusIOPS every two quarters on an
9 on-going basis—or even if they had merely believed that EMC would be making
10 any substantial purchases at all during the first half of 2010—and if STEC and its
11 senior officers had been producing product to meet that new, higher level of
12 demand from EMC, then, when it subsequently turned out that EMC would not be
13 making **any** ZeusIOPS purchases during the first half of 2010, STEC itself should
14 have been left with huge excess inventory that it had generated for the purpose of
15 satisfying EMC's expected purchase requests during the first half of 2010. As
16 CW5 has stated, STEC needed "months" of lead time to manufacture SSDs.

17 63. However, completely contrary to any such scenario, STEC reported
18 *no* excess inventory of its own in the fourth quarter of 2009. Indeed, STEC's 2009
19 10-K reported inventory of approximately \$43 million, which was *substantially*
20 *less* than the \$64 million of inventory that STEC had reported *a year earlier* in its
21 Form 10-K for 2008. This is a 33% *decline* in STEC's inventory, after a year in
22 which reported sales had *increased* by 55.8%—*clearly not what one would expect*
23 *from a company planning for sustained growth in sales.*

24 64. Nor can this inventory decline be attributed to any change in STEC's
25 volume of production after it made the November 3, 2009, disclosure that EMC
26 had excess inventory. As reported in STEC's 10-Q for the third quarter of 2009,
27 STEC's inventory at the end of the third quarter was already down to \$35.6
28 million—a 44% decline from the end of 2008.

1 65. Moreover, the decline in STEC's inventory also cannot be attributed
2 to any problem on STEC's part in increasing its production to meet an expected
3 increase in demand from EMC—or from anyone else. During the August 3, 2009,
4 conference call, when an analyst asked whether there would be “any inventory
5 impacts” on STEC as a result of the \$120 million contract, Manouch Moshayedi
6 responded, “I think we’ll be comfortable.” Similarly, the fact that STEC was
7 having no problem meeting the demand for product from EMC is shown by the
8 fact that EMC ended up with excess inventory.

9 66. Fifth, because EMC's purchase of \$120 million of ZeusIOPS product
10 was a purchase more than *three times as large* as EMC's total purchases from
11 STEC *during the entire preceding year*, it was, *at a minimum*, reckless for STEC to
12 make statements suggesting that the Agreement represented a new, higher,
13 on-going level of purchases by EMC.

14 67. Sixth, as stated by CW4, the former Chief Technologist for Storage
15 and Data Management at Sun Microsystems, 2009 was a very bad year for the IT
16 (Information Technology) business, and in fact companies such as Sun were
17 having layoffs. According to CW4, the poor climate in the IT world in 2009 made
18 the \$120 million EMC Supply Agreement “peculiar.” This too made it at least
19 reckless for STEC to have led investors to believe that the EMC Supply Agreement
20 would cover EMC's requirements for only two quarters.

21 68. As early as the first announcement of the EMC Supply Agreement, on
22 July 12, 2009, Manouch and Mark Moshayedi each knew or was reckless in not
23 knowing that the Agreement covered EMC's needs well beyond the second half of
24 2009. According to CW7, the Moshayedi brothers were directly and personally
25 involved in all aspects of the EMC business, and stated that they were “very
26 involved” with the business and “larger opportunity deals” (like EMC). CW5
27 confirmed that the Moshayedi brothers were heavily involved in the Company's
28

1 large deals, explaining that “nothing happened at that place without those two.”
2 According to CW1, Manouch Moshayedi directly oversaw all sales.

3 **2. Additional Evidence Of The Exchange Act Defendants’**
4 **Scienter For Their Misleading Statements Regarding The**
5 **EMC Supply Agreement Is Their Failure, In Knowing**
6 **Violation Of Reg. S-K, To Disclose The Terms Of The EMC**
7 **Supply Agreement**

8 69. The above-referenced circumstances strongly support an inference
9 that, with the knowledge of the Exchange Act Defendants, the EMC Supply
10 Agreement represented the advancing into the second half of 2009 of purchases
11 intended by EMC to cover its needs well into 2010.

12 70. The same inference is supported by the statements of CW4, the Chief
13 Technologist for Storage and Data Management at Sun Microsystems, who stated
14 that, based on his industry experience, EMC would have “pre-bought” ZeusIOPS
15 units in order to get better pricing. CW4 opined that the EMC Supply Agreement
16 was at least partly the result of STEC having reduced its price in order to induce
17 EMC to advance its purchases.

18 71. Moreover, the same inference is supported by STEC’s failure—in
19 knowing violation of Item 601(b)(10) of the SEC’s Regulation S-K (“Reg. S-
20 K”)—to disclose the terms of the EMC Supply Agreement by publicly filing a
21 copy of it with the SEC.

22 72. Pursuant to Item 601(b)(10) of Reg. S-K and its instructions, “[e]very
23 contract not made in the ordinary course of business which is material to the
24 registrant,” and, even if made in the ordinary course of business, “[a]ny contract
25 upon which the registrant’s business is substantially dependent” must be filed with
26 the Form 10-Q or 10-K for the period during which the contract was executed.
27 Among other justifications for this requirement, by disclosing to investors the
28 terms of the contract, it protects them from being misled into believing that a

1 significant one-time contract obtained, for example, by the registrant having made
2 extraordinary promises, is indicative of an ongoing trend in the issuer's results of
3 operations.

4 73. To this day, STEC has never filed the \$120 million EMC Supply
5 Agreement with the SEC.

6 74. Moreover, no later than at the end of August 2009, STEC was on
7 notice that failure to file a contract of such central importance to its business would
8 be viewed as highly questionable by the SEC, because, by letter dated August 28,
9 2009, the SEC wrote to STEC questioning STEC's failure to file *other* agreements
10 with EMC that were made during the previous year, when EMC did not even
11 account for as large a portion of STEC's business as it would come to account for
12 at the time of the EMC Supply Agreement.

13 75. Thus, by letter dated August 28, 2009, the SEC asked why no "master
14 agreement" with EMC, such as was referred to in STEC's 2008 10-K, had been
15 filed with that Form 10-K, given that, even at that early date, EMC already
16 accounted for 15.2% of STEC's total revenues. The SEC also stated that, "If it is
17 your belief that you're not substantially dependent on any such agreement such
18 that it is not required to be filed pursuant to Item 601(b)(10)(ii)(B) of Reg. S-K,
19 please provide analysis in support of this belief in your response letter."

20 76. STEC's only proffered defense for this earlier failure was an argument
21 that STEC knew could not excuse its failure to file the EMC Supply Agreement.
22 Thus, by publicly filed letter, dated September 10, 2009, signed by Defendant
23 Raymond Cook, the Exchange Act Defendants responded to the SEC that,
24 "STEC's master agreements typically are non-exclusive and *do not contain any*
25 *binding long-term volume commitments* . . . actual sales of STEC products are
26 made through more specific sales agreements such as individual purchase orders."
27
28

1 77. Even as regards STEC's earlier agreements with EMC, the SEC was
2 not satisfied with STEC's answer. Thus, by letter dated September 30, 2009, the
3 SEC again wrote to STEC, stating

4 ***[I]t remains unclear to us how you have concluded that***
5 ***you are not substantially dependent upon any of your***
6 ***agreements with . . . EMC Corporation,*** such that they
7 are not required to be filed pursuant to Item
8 601(b)(10)(ii)(B) of Regulation S-K. We note your
9 statements that STEC's master agreements typically are
10 nonexclusive and that they do not contain any binding
11 long-term volume commitments, and that actual sales are
12 made through more specific sales agreements such as
13 purchase orders. . . . ***With respect to any individual***
14 ***purchase order that accounted for a significant amount***
15 ***of the company's revenues, please advise how you***
16 ***concluded that any such purchase order is not required***
17 ***to be filed as a material contract under Item 601(b)(10).***

18 78. By publicly filed letter dated October 13, 2009, and again signed by
19 Raymond Cook, STEC responded that "STEC received over 100 individual
20 purchase orders from EMC related to 2008 deliveries. ***The amounts of these***
21 ***purchase orders ranged from \$450 up to approximately \$5.2 million for the***
22 ***largest individual purchase order.*** . . . As a result, STEC believes that none of the
23 individual EMC purchase orders received for 2008 shipments constitutes a material
24 contract under Item 601(b)(10) of Regulation S-K.

25 79. Some time after STEC sent its second letter to the SEC and before
26 STEC issued its 2009 Form 10-K, the SEC launched its formal investigation of
27 STEC stock sales and issued subpoenas to Manouch Moshayedi and other STEC
28 employees.

1 80. The Exchange Act Defendants knew or were reckless in not knowing
2 that their attempted excuse for STEC's failure to file any agreements with EMC at
3 the time of its 2008 Form 10-K could not excuse STEC's failure to file the EMC
4 Supply Agreement at the time of its 2Q09 Form 10-Q. The only excuse that STEC
5 even attempted for its failure to file an EMC Supply Agreement with the 2008
6 Form 10-K was that the largest actual purchase order by EMC during 2008 was for
7 only \$5.2 million. Obviously, such an argument could not possibly excuse STEC's
8 failure to file the EMC Supply Agreement, since that agreement was for \$120
9 million—an amount *23 times larger* than STEC's largest previous binding
10 commitment from EMC.

11 81. Moreover, while the SEC expressed concern about STEC's failure to
12 file any agreement with EMC during a period in 2008 in which EMC accounted for
13 as much as 15.2% of STEC's revenues, EMC's importance to STEC subsequently
14 increased, until, by the second quarter of 2009, EMC accounted for 38.9% of
15 STEC's revenues, as disclosed in STEC's Form 424B3 filed on August 3, 2009.

16 82. Therefore, the Exchange Act Defendants' failure to file the EMC
17 Supply Agreement along with the 2Q09 Form 10-Q violated Reg. S-K, the
18 violation was committed with knowledge that it could not be justified, and the fact
19 that it was a knowing violation raises an inference that Defendants were motivated
20 by a desire to conceal the truth about the EMC Supply Agreement from investors.
21 Moreover, STEC's September 10, 2009, letter to the SEC falsely asserted that, "in
22 the unlikely event a customer should default under a purchase order or other sales
23 agreement, ***STEC generally believes it could find a replacement customer for the***
24 ***relevant product.***" As further explained, *infra*, in the next section, at the time of
25 STEC's September 10, 2009, letter to the SEC, Defendants knew that no other
26 customer was currently ready to make purchases of ZeusIOPS on the same scale as
27 the purchases under the EMC Supply Agreement.

28

C. **The Exchange Act Defendants Misrepresent That STEC's Other OEM Customers Will Follow In EMC's Footsteps By Increasing Their Orders Of ZeusIOPS During The Second Half Of 2009**

83. Throughout most of the Class Period, the Exchange Act Defendants strove to create a false impression that STEC's revenues from its sales of ZeusIOPS were expected to continue increasing hugely from quarter to quarter, as additional OEM customers increased the volume of their purchases in the same way that the \$120 million EMC Supply Agreement had increased the volume of EMC's purchases.

84. In particular, during STEC's earnings conference call on August 3, 2009, the Exchange Act Defendants made misleading statements creating a false impression that, within the following two quarters, each of four other large OEM customers² were expected to increase the volume of their purchases of ZeusIOPS to a level equivalent to the new level of ZeusIOPS purchases recently announced by EMC.

85. When analyst Aaron Rakers questioned when STEC's large OEM customers other than EMC would reach "full production" of their products incorporating ZeusIOPS, Manouch Moshayedi responded, "It's still a, I would say, maybe *a quarter or two away from full ramping production.*"

86. As explained, *supra*, "full production" as the phrase was used during STEC conference calls was to be contrasted with "pre-production"—a period during which an OEM creates only samples of its product incorporating ZeusIOPS. Therefore a transition to full production by the other OEMs would mean a transition by them to a phase currently being experienced only by EMC, and an

² During the earnings release conference call on November 3, 2009, Manouch Moshayedi explained that STEC's five largest customers were "EMC, IBM, Hitachi Data Systems, Hewlett-Packard, and Sun."

1 increase in the volume of the purchases of ZeusIOPS by these other OEMs
2 equivalent to, as Manouch Moshayedi said on August 3, “those sort of volumes”
3 being purchased by EMC.

4 87. Analysts’ response to Manouch Moshayedi’s assertions show their
5 understanding that he was predicting continued quarter to quarter revenue growth
6 based on STEC’s OEM customers other than EMC immediately following in
7 EMC’s footsteps.

8 88. On August 4, 2009, Needham published an analyst report reiterating a
9 “strong buy” rating, and stating:

10 STEC’s string of successes continued in the June quarter,
11 with strong growth in ZeusIOPS and impressive margins.

12 *We expect this trend to repeat* as STEC’s customers
13 ramp and deploy enterprise SSDs into the marketplace.

14 89. On August 10, 2009, Wedbush Morgan (“Wedbush”) initiated
15 coverage of STEC with an “outperform” rating, and stated:

16 STEC has secured a \$120 [million] supply agreement
17 with one of its leading customers who we believe to be
18 EMC Corporation. We expect due to STEC’s monopoly
19 of the fibre channel SSD market that *it will likely secure*
20 *similar supply agreements with the company’s other*
21 *Tier I OEMs. We expect these announcements* to be
22 positive catalysts *in the near term* driving shares higher.

23 90. On August 16, 2009, Deutsche Bank initiated coverage of STEC with
24 a “buy” rating, stating:

25 STEC has a considerable lead over competitors in the FC
26 market, where its products are shipping in EMC systems.

27 STEC is also ramping new business with IBM, HP,
28

1 Hitachi and Sun, and we expect these customers'
2 volumes to grow *over the next few quarters*.

3 91. On September 10, 2009, STEC reinforced its assertion that its other
4 OEM customers would be ramping their purchases to a level like EMC's before the
5 end of 2009, when it stated in its publicly filed response to the SEC's inquiries
6 concerning STEC's contracts with EMC that "in the unlikely event a customer
7 should default under a purchase order or other sales agreement, STEC generally
8 believes it could find a replacement customer for the relevant product."

9 92. However, one quarter later, during the November 3, 2009 earnings
10 conference call, when increased purchases by STEC's OEM customers other than
11 EMC had not yet materialized, analysts believed that STEC's assertions at the
12 August 3 conference call and in STEC's letter to the SEC had proven to be false.
13 Thus, when Defendant Manouch Moshayedi admitted that "most of our ZeusIOPS
14 is done through EMC[; t]he rest of the customers are pretty small in terms of the
15 ZeusIOPS sales," and blamed the absence of purchases by the other OEMs on
16 resistance to ZeusIOPS by the other OEMs' own customers, analyst Matthew
17 Gretsch responded:

18 I still, after an hour on this call, don't seem to grasp what
19 the basis of [the OEMs'] customers' skittishness is. . . .
20 [Y]ou must, at this point, have some feedback from your
21 customers' customers as to what they are looking for and
22 why *this thing hasn't progressed as quickly as you had*
23 *thought*.

24 93. Moreover, at the November 3, 2009 conference call, Defendant
25 Manouch Moshayedi implicitly admitted that that his previous statements had been
26 intended to create an expectation of increased purchases within two quarters, and
27 attempted to recycle that very prediction—though he now referred to a different
28 two quarters (*i.e.*, now, at the end of the 2009 third quarter, he predicted increased

1 purchases by the end of the 2010 first quarter), and re-characterized the recycled
2 prediction as a mere “hope.” Thus, during the November 4, 2009, conference call,
3 he stated, “maybe [the OEMs other than EMC] took their foot off of the pedal a
4 little bit. But I think their foot is back on the pedal again, and hopefully we’ll see
5 the results of it in the next couple of quarters.”

6 94. By the time of the 2009 fourth quarter earnings conference call on
7 February 23, 2010, when increased purchases by the OEMs other than EMC *still*
8 had not materialized, the Exchange Act Defendants’ prior assertions during the
9 August 3, 2009, conference call and September 10, 2009, letter to the SEC had
10 been shown to be transparently false. When analyst Sherri Scribner asked if STEC
11 expected “some revenue from some of your other ZeusIOPS customers” during the
12 first quarter of 2010, Manouch Moshayedi finally gave up his prior practice of
13 predicting a huge ramp of purchases within the next two quarters, and, instead,
14 stated “we put second half [of 2010, *i.e.*, within the next *four* quarters] as the time
15 to see growth again in this market.”

16 95. The contrast between the Exchange Act Defendants’ assertion during
17 the August 3, 2009 conference call, and their admission during the February 23,
18 2010, conference call is reflected in the contrast between the Needham analyst
19 report following the August 3, 2009, conference call—which predicted second
20 quarter growth to “*repeat*” “*as STEC’s customers ramp,*”—and the Needham
21 analyst report published on February 24, 2010, which forecasted two successive
22 quarters of *losses* and stated that “the company remains heavily levered to pulls
23 from its first and primary customer,” while “*the remaining customers [are] far*
24 *behind in their own ramps.*”

25 96. Although the analysts had been fooled, the Exchange Act Defendants
26 had known from as early as August 3, 2009, when they made their first false
27 statement about their other OEM customers, that no ramping of purchases of
28 ZeusIOPS by these customers would be forthcoming during the second half of

1 2009—or else they recklessly ignored their own ignorance while making the
2 statement.

3 97. At all relevant times, the Exchange Act Defendants knew whether
4 there would be a major change in the volume of the purchase orders that STEC
5 would be receiving within the next six months, as shown by the fact that, in
6 STEC's earnings release for the fourth quarter of 2008, filed on March 12, 2009,
7 STEC stated that it expected ZeusIOPS revenue "for just the first six months of
8 2009" to "surpass the total of ZeusIOPS revenue achieved during the full-year
9 2008," ***"[b]ased on current customer indications and momentum."*** In addition to
10 showing that Defendants received customer indications of major purchases six
11 months in advance, this statement also led investors to *believe* that STEC received
12 customer indications of major purchases six months in advance.

13 98. In addition, as early as August 3, 2009, the Exchange Act Defendants
14 had to know whether a ramp in purchase orders was coming during the next two
15 quarters on a scale equivalent to *up to four times the ramp resulting from EMC's*
16 *increased volume of purchases during the second half of 2009*, because without
17 some advance notice from the purchasers as to whether such a huge ramp was
18 coming, STEC would never have been able to ramp its production in time to meet
19 the orders. As Defendant Manouch Moshayedi stated during the August 3, 2009
20 conference call, "when you get to a point where the amount of components that
21 you need are extremely large, we can't, or we won't, at least, go make those
22 commitments to our suppliers and bring the parts in on a whim. We need to have
23 ***[a] very solid forecast and solid commitments*** in order to do that."

24 99. The absence of any such advance notice having been given to STEC is
25 shown by the fact that, after the second half of 2009, STEC never reported that it
26 had any substantial unsold ZeusIOPS product resulting from failures by the OEMs
27 to follow through on purchases that they had given STEC reason to believe were
28 coming.

1 100. Still further, Defendants knew at all relevant times that their OEM
2 customers other than EMC would not be ramping their purchases during the
3 second half of 2009 to a volume like that of the EMC Supply Contract, because,
4 for the reasons stated, *supra*, they knew that *even EMC* was not capable of selling
5 in six months, all of the ZeusIOPS that it had agreed to purchase for that period.
6 As stated by CW4 who worked at Sun Microsystems, it would have taken Sun
7 *three years* to sell as much product incorporating ZeusIOPS as EMC had
8 undertaken to sell with its \$120 million purchase.

9 **D. The Exchange Act Defendants Artificially Inflate STEC's**
10 **Revenues By Reporting Unearned Revenues And By Channel**
11 **Stuffing**

12 101. As numerous mutually reinforcing statements of confidential
13 witnesses establish, in the period leading up to and including the Class Period,
14 STEC developed practices generally used for inflating revenues, and as the history
15 of STEC's reported revenues before, during and after the Class Period
16 demonstrate, these practices were used to inflate STEC's revenues and revenue
17 guidance during the Class Period and especially as reported just prior to the
18 secondary stock offering on August 6, 2009.

19 **1. The Exchange Act Defendants Shipped Defective, Unusable**
20 **Product To Customers In Order To Report Revenue**

21 102. According to CW6, who was a Test Engineer at STEC's main facility
22 in Santa Ana, California from February 2005 until December 2008, at the end of a
23 quarter STEC shipped out units that had errors in them. He said that the reason
24 this was done was to get the product shipped out, and to get proof of delivery from
25 the customer's location so that STEC could book the sale. He said that some of
26 these units were not even functional. STEC even sent customers "second hand"
27 units, meaning units that were returned by one customer and then sent to another.
28

1 103. CW6 also said that STEC's Test Engineers were told to skip tests that
2 were supposed to be run on the units prior to shipping, in order to speed up the
3 shipment of units to customers, in order to book sales. Test Engineers were
4 instructed to skip tests on the speed at which the units processed reading and
5 writing data. He believed that the instructions to skip tests came from STEC's
6 marketing department or the Moshayedis. CW6 also stated that when EMC
7 returned products, STEC would make, or "allegedly" make, corrections and resend
8 them to EMC, only for EMC to return the units again.

9 104. CW1 worked at STEC for five years, from June 2004 until July 2009.
10 She was coordinator of sales to Hewlett-Packard and in 2009 reported to Lorenzo
11 Salhi, who reported directly to Manouch Moshayedi. CW1 said she saw Manouch
12 Moshayedi on a daily basis.

13 105. CW1 explained that STEC shipped products that had a high failure
14 rate to HP, but then lied to HP about the failure rate. When CW1 discovered that
15 STEC was shipping failed products to HP, she reported it by email, around May
16 2009, to Eddie Martinez, STEC's Director of Production. The Director of
17 Production told her "not to broadcast it [the fact that STEC was shipping failed
18 products] on email," and to discuss it with her boss, Lorenzo Salhi. Mr. Martinez
19 later told CW1 that Mr. Salhi (who reported directly to Manouch Moshayedi) told
20 Mr. Martinez to "make up those numbers."

21 106. CW1 described an incident where STEC sent HP defective products
22 and falsified the failure rate in order to make STEC's sales numbers for the second
23 quarter of 2009. When STEC tested the modules, 35 (or about 10%) failed. Mr.
24 Salhi replaced the failed modules and returned them in May or June of 2009, to HP
25 with a report that falsely stated only 2 of the units had failed. HP shipped these
26 modules to its customers, where they again failed. CW1 said the modules were
27 shipped back to HP because STEC needed to make its numbers for that month or
28

1 quarter. CW1 said that Manouch Moshayedi told Mr. Salhi “I don’t care what you
2 have to do, get those modules back to HP.”

3 107. CW11, a Failure Analysis Technician at STEC responsible for
4 analyzing and reporting on failed STEC products, confirmed that STEC
5 management was dishonest in reporting product failures to customers, including
6 denying known product failures, altering failure reports, and changing serial
7 numbers on products.

8 108. Several CWs reported that the ZeusIOPS was not “up to snuff,” and
9 that there was some “real struggling” with “quality issues.” CW3 said there were
10 substantial problems with ZeusIOPS – it was “like a brick; all it would do, just the
11 light would flash on and off.” CW2 said EMC returned many ZeusIOPS units due
12 to “power issues” and overheating. CW9 described occasions when customers
13 returned products to STEC, STEC repaired and returned the product, only to have
14 the unit fail again.

15 **2. The Exchange Act Defendants Inflated Revenues By**
16 **Shipping Customers Product They Had Not Ordered**

17 109. Another way in which the Exchange Act Defendants artificially
18 inflated revenues was by channel stuffing, or sending customers unwanted product.
19 For example, CW1 reported that when Hewlett-Packard received from STEC a
20 shipment of which 10% of the products failed, HP placed STEC on a “world wide
21 stop shipment” hold. Manouch Moshayedi nonetheless ordered that replacement
22 product be shipped to HP. According to CW1, the modules were shipped to HP in
23 May or June of 2009 because STEC needed the sales that month/quarter. When
24 HP received the modules, HP’s procurement engineer “hit the roof” and said that
25 STEC should not have shipped them.
26
27
28

1 **3. The Exchange Act Defendants Inflated Revenues By**
2 **Channel Stuffing**

3 110. Another deceptive practice used by the Exchange Act Defendants to
4 artificially inflate revenues was to pressure customers to accept in a current quarter
5 product that they did not need until a later quarter, so that STEC could record that
6 revenue from the sale in the current quarter.

7 111. CW1 reported that Manouch Moshayedi directed her boss, Lorenzo
8 Salhi, to pull all sales of product to Cisco from a future quarter in 2009 to an
9 earlier quarter. She did not recall the precise quarter in which this happened since
10 “it happened all the time.” She also recalled an instance where STEC pulled sales
11 from the first quarter of 2009 into the last quarter of 2008 in order to make its 2008
12 numbers.

13 112. CW1 stated that she was told by a Sales Director, who reported to
14 Manouch Moshayedi and who attended sales meetings with Manouch Moshayedi,
15 that at those sales meetings, Manouch would tell everyone to push sales from a
16 future quarter to the present quarter. This was done to make the current quarter
17 look good. The future quarter would then look bad, so Manouch would again
18 pressure customers to move sales from a future to a current quarter, and thus the
19 process continued. CW1 stated that Manouch “had his hands on everything when
20 it came to sales.”

21 113. CW1 stated that she was told by STEC salesperson, who worked in
22 Houston on the HP account and reported to Lorenzo Salhi (and who was in charge
23 of Cisco sales), that “Cisco must take everything this quarter” because he wanted
24 “grand numbers” that quarter.

25 114. CW1 stated that she was told by STEC salesperson, who worked in
26 Houston on the HP account and reported to Lorenzo Salhi (and who was in charge
27 of Cisco sales), that “Cisco must take everything this quarter” because he wanted
28 “grand numbers” that quarter.

1 115. CW8 noted that STEC would ask customers whether they would
2 accept product in the current quarter to meet their needs for the following quarter:
3 “[W]e did ask the customers, ‘Hey, look, we’re trying to make our number, quarter
4 number, and will you work with us? Would you take extra product that would be
5 for the next quarter?’”

6 **4. The Exchange Act Defendants Inflated Revenues By**
7 **“Shipping Bricks” and Empty Boxes**

8 116. Another deceptive practice the Exchange Act Defendants used to
9 manipulate reported revenues was to “ship bricks” and empty boxes so that they
10 could record revenue from those phantom shipments to meet revenue goals.

11 117. During his tenure at STEC (2005-2008), CW6 witnessed STEC’s
12 practice of “shipping bricks.” According to CW6, the phrase “shipping bricks”
13 originated because when the shipping palette is loaded with boxes, the boxes look
14 like bricks. According to CW6, the boxes would be filled with operable product,
15 dysfunctional product, second hand product and “junk.” CW6 also recalled seeing
16 an entire palette of empty boxes marked ZeusIOPS being prepared to be shipped.

17 118. CW6 was told by people he worked for that the purpose of “shipping
18 bricks” was to “reach revenue levels each quarter” and that this was common
19 knowledge. CW6 said that there was always a “rush” to get these “brick”
20 shipments out. CW6 recalled a specific instance of being told by Director of
21 Operations Shane Mortazavi to get the shipment out that afternoon.

22 119. CW6 heard from Mr. Mortazavi and others that it was Mike or Mark
23 Moshayedi who was “pushing” the shipments of “bricks.” CW6 further advised
24 that the Moshayedis made all the decisions at STEC, because that was the culture
25 at the Company.

26 120. Likewise, CW10, who was a STEC Field Application and Sales
27 Engineer from September 2007 until November 2009, confirmed that it was
28

1 STEC's practice to engage in "shipping bricks," which involved shipping empty
2 boxes or the wrong product to customers.

3 **5. STEC's 2009 Second Quarter Revenue Is Inflated**

4 **(a) STEC's 2009 Reported Revenue Has The Character**
5 **Of A Bubble Created For The Purpose Of Unloading**
6 **The Individual Defendants' Stock**

7 121. The history of STEC's reported revenue during 2009 shows it to have
8 been a bubble that (1) expanded with increasing rapidity right up to the end of the
9 second quarter—just before the secondary stock offering, (2) expanded ever more
10 slowly for two quarters thereafter, and then (3) completely collapsed at the end of
11 the year.

12 122. After falling in the fourth quarter of 2008, STEC's reported revenues
13 increased in every quarter of 2009 compared to the previous quarter, before
14 collapsing again in the first quarter of 2010. Reported revenues increased 12% in
15 the first quarter of 2009, *a whopping 36% in the second quarter* (three times
16 greater than the rate of growth in the first quarter), 14% in the third quarter, and
17 8% in the fourth quarter. STEC's reported revenues then plummeted *63.4% in the*
18 *first quarter of 2010*.

19 123. However, this period of revenue growth was as short as it was
20 spectacular. In its earnings release for the fourth quarter of 2009, the Exchange
21 Act Defendants announced revenue guidance of only \$33-35 million for the first
22 quarter of 2010, a prediction that was borne out by STEC's Form 10-Q for the first
23 quarter of 2010, which reported revenues of only \$38.8 million.

24 124. The shape of this bubble, with the secondary offering occurring right
25 after STEC reported its most impressive spurt of revenue growth (and with the
26 stock price having reached a level nine times higher than its level at the end of
27 2008), creates an inference that the entire bubble was created as a result of
28 revenues being managed so that the Individual Defendants' stock could be

1 unloaded at an inflated price, and that the entire bubble ultimately collapsed for the
2 simple reason that such management techniques as, *e.g.*, shipping defective or
3 unrequested product had diminishing returns and, eventually, counterproductive
4 results.

5 (b) **STEC's Class Period Achievement Of Repeatedly**
6 **Beating Guidance By The Same Small Amount**
7 **Supports An Inference That Revenues Were Being**
8 **Managed**

9 125. In every quarter of 2009, STEC's reported revenues also exceeded the
10 Company's previous "guidance" for the quarter. As shown by the following chart,
11 the excess of reported revenues over guidance was very similar in each quarter.

12

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
13 STEC's 14 Guidance	\$58-60 million	\$68-70 million; \$82-84 million	\$95-97 million	\$101-103 million
15 Reported Results	\$63.5 million	\$86.4 million	\$98.3 million	\$106 million

16

17 126. In the context of the overall revenue bubble, the secondary offering at
18 the height of the bubble, and the evidence that STEC practiced conduct usually
19 used for inflating revenues, the fact that STEC was perpetually able to beat its own
20 guidance, and did so, in each instance, by the same small amount, suggests that the
21 revenues were being managed by the Exchange Act Defendants so that STEC
22 could impress growth oriented investors by reporting that it was exceeding its own
23 guidance. This is especially true given that STEC managed to beat its guidance in
24 the second quarter even after increasing its guidance.

25
26
27
28

(c) **The First Quarter 2010 Collapse Of STEC's Reported Revenues Was Too Large To Be Explainable By STEC's Only Proffered Explanation, Namely, The Cessation Of Purchases By EMC**

127. With the guidance announced by the Exchange Act Defendants in STEC's earnings release for the fourth quarter of 2009, not only had the Company's revenues stopped growing at an accelerating rate, and not only had they had stopped growing at any rate, and they had also gone into decline. Moreover, the decline was so great that, not only were the revenues for the first quarter of 2010 lower than the revenues for the fourth quarter of 2009, but also, *the revenues for the first quarter of 2010 were lower than the revenues had been for the fourth quarter of 2008*—which, according to STEC's earnings release for the fourth quarter of 2008, were \$56.9 million. Still further, this was true despite the fact that the fourth quarter of 2008 had been a particularly bad quarter, with revenues below those of the third quarter of 2008, and below STEC's guidance for the fourth quarter of 2008.

128. Moreover, although EMC did not make any purchases from STEC during the first quarter of 2010, this fact cannot explain the extent of the collapse of STEC's 2010 first quarter revenues. STEC's entire reported revenue for the first quarter of 2010, \$38.8 million, was *\$14 million less* than the amount of revenue reported by STEC in the second quarter of 2009, *even after removing from the 2009 second quarter revenue that part of the revenue that was attributable to purchases by EMC*. Thus, according to STEC's Form 424B3 filed on August 3, 2009, EMC accounted for *38.9% of STEC's revenues* in the second quarter of 2009. Given that STEC reported \$86.4 million of revenue in the second quarter of 2009, that means that STEC reported \$52.8 million of revenue from sources *other* than EMC during the second quarter of 2009. Therefore, during the second quarter of 2009, just prior to the secondary offering, STEC reported revenue from sources

1 other than EMC that was *\$14 million more* than the revenue reported from sources
2 three quarters later, and despite the fact that STEC repeatedly claimed that
3 purchases of ZeusIOPS were increasing with the passage of time.

4 129. Therefore, the extraordinary revenue numbers reported by the
5 Exchange Act Defendants for the second quarter of 2009 cannot have been
6 justified based on any temporary enlargement of the orders STEC received from
7 EMC.

8 130. When this fact is *combined with* (a) the testimony of multiple
9 witnesses that STEC routinely shipped defective or unordered product and empty
10 boxes, and engaged in undisclosed channel stuffing, (b) the fact that the history of
11 STEC's reported revenue during 2009 has the shape of a bubble, with STEC's
12 CEO and COO having sold off over 50% of their stock at the height of the bubble,
13 just after STEC reported its fastest rate of quarterly revenue growth, and (c) the
14 fact that, after missing its guidance in the fourth quarter of 2008, STEC beat its
15 final guidance in five straight quarters, and did so in every one of the five quarters
16 by similarly small amounts, the result is a strong inference that, for the purpose of
17 creating a false impression of ongoing revenue growth, the Exchange Act
18 Defendants materially misstated STEC's revenues reported for 2009, and, in
19 particular, materially misstated STEC's revenues for the second quarter of 2009—
20 the quarter that immediately preceded the insider stock sales and that, among all of
21 the quarters of 2009, involved the largest amount of reported revenue not
22 attributable to orders from EMC.

23 **6. By Inflating Its Revenues, STEC Violates**

24 **GAAP And Regulation S-K**

25 131. Public companies are required by the SEC to prepare their financial
26 statements in accordance with Generally Accepted Accounting Principles
27 ("GAAP"). Under SEC Rule 4-01(a) of SEC Regulation S-X, "[f]inancial
28 statements filed with the [SEC] which are not prepared in accordance with

1 [GAAP] will be presumed to be misleading or inaccurate.” 17 C.F.R.
2 § 210.4-01(a)(1).

3 132. Each of STEC’s Forms 10-Q filed during 2009 contained a statement
4 that “the accompanying interim condensed consolidated financial statements of
5 STEC . . . have been prepared in accordance with accounting principles generally
6 accepted in the United States of America (‘GAAP’) for interim financial
7 information.”

8 133. Under the SEC’s Staff Accounting Bulletin No. 104 (“SAB 104”),
9 which interprets FASB Concepts Statement No. 5 (“Con 5”), which, in turn,
10 summarizes GAAP rules regarding revenue recognition, “revenue should not be
11 recognized until it is realized or realizable and earned,” and such a condition does
12 not exist unless “delivery has occurred or services have been rendered” *and*
13 “collectibility is reasonably assured.” By recognizing revenue based on the
14 shipping of (a) empty boxes, (b) defective product, and (c) product shipped despite
15 the absence of any order, STEC violated GAAP and thereby made false statements
16 in its financial statements contained in its Form 10-Qs for the second and third
17 quarters of 2009.

18 134. As established by Item 303(b) of Reg. S-K, Item 303 sets forth the
19 requirements for “management’s discussion and analysis of financial condition and
20 results of operations” in Forms 10-Q.

21 135. Item 303(a)(3)(ii) of Reg. S-K requires the registrant to “describe any
22 known trends or uncertainties that have had or that the registrant reasonably
23 expects will have a material favorable or unfavorable impact on sales or revenues
24 or income from continuing operations.” Channel stuffing has the result of shifting
25 revenues into earlier quarters to the detriment of later quarters. Therefore, STEC’s
26 failure to disclose its channel stuffing in the MD&A section of its second quarter
27 and third quarter Forms 10-Q was a violation of Reg. S-K.

28

1 136. The \$120 million EMC Supply Agreement, along with STEC's public
2 statements that the contract was indicative of expected future sales growth, created
3 a misleading impression that STEC's revenues during the second half of 2010
4 indicated a new and higher trend in revenues. Therefore, STEC's failure to
5 disclose in the MD&A section of its 2009 second quarter Form 10-Q that the EMC
6 Supply Agreement was not likely to be repeated in the foreseeable future, and was
7 not likely to be replaced in future quarters by similar contracts with other
8 customers, was a violation of Reg. S-K.

9 137. Because STEC's revenues reported during 2009 had been
10 misleadingly inflated, analysts were unprepared for the first quarter 2010 guidance
11 issued by STEC in its February 23, 2010 earnings release.

12 138. On February 24, 2010, J.P.Morgan published an analyst report stating
13 that "the disappearance of sustainable revenue momentum *up-ended our prior*
14 *view* that STEC was the high-growth story in SMid Cap. . . . *STEC expects 1Q10*
15 *revenues of \$33-35M, versus our prior estimate of \$96.7M.* The flow-through
16 effects of this are *staggering* to the overall model."

17 139. Also on February 24, 2010, Thomas Weisel Partners issued an analyst
18 report stating that STEC's "March quarter outlook came in well below even the
19 most cautious Street estimates," and Wedbush published an analyst report stating
20 that "STEC's Q1 outlook [is] far below the Street and our expectations."

21 **E. The Exchange Act Defendants Misrepresent ZeusIOPS**
22 **Competition**

23 140. From the beginning of the Class Period, the Exchange Act Defendants
24 maintained that STEC had a virtual monopoly in the SSD market with ZeusIOPS,
25 and faced "no competition." For example, on August 3, 2009, on a telephone
26 conference with analysts and investors, Defendant Manouch Moshayedi stated,
27 "*As you know, we have no competition at this stage.*" He further stated, "*I would*
28

1 *give the probability of someone coming out with a Fibre Channel interface,*
2 *ZeusIOPS-like SSD a zero.”*

3 141. CW1 stated that there was “huge” competition for the ZeusIOPS.
4 According to CW1, companies competing with STEC’s ZeusIOPS product were
5 IBM, Samsung, Toshiba, SMART Modules, and Kingston.

6 142. In truth, the Exchange Act Defendants knew and/or deliberately
7 disregarded that competition had entered the market. For example, STEC’s
8 competitor, Pliant Technology, had begun sampling an enterprise SSD with
9 customers and expected an initial qualification in the fourth quarter of 2009. They
10 also knew and/or deliberately disregarded that other competitors, such as Hitachi,
11 were on track to qualify its SSD in early 2010. Indeed, Defendant Manouch
12 Moshayedi later admitted in a September 21, 2009 interview (after the Moshayedis
13 had unloaded their stock for hundreds of millions of dollars), STEC “never
14 expected to be a single source in this market forever . . . [i]t’s perfectly inevitable
15 that people will have second or third qualified vendors in this market.”

16 143. On September 17, 2009, Wedbush published an analyst report on
17 STEC that identified important new adverse information regarding competition for
18 ZeusIOPS, which the Exchange Act Defendants had adamantly and repeatedly
19 denied could exist. The report, entitled, “Checks Indicate Q3 Beat Likely in Cards;
20 but Expect Changing Competitive Landscape to Pressure Shares Downward,”
21 disclosed for the first time that the “competitive landscape” was “intensifying,”
22 and that STEC’s “window of opportunity to maintain a market leadership position
23 and secure design wins at Tier I OEMS in the SATA/SAS SSD enterprise market
24 ahead of the competition may be closing.” It stated that industry checks indicated
25 that one of the Company’s Tier I enterprise customers was “in the final
26 qualification stages” with Toshiba for SSDs, and that a leading hard drive company
27 was likely to introduce single-level cell and/or multi-level cell SSDs in the fourth
28 quarter of 2009. It further stated that, whereas Wedbush had previously expected

1 competitors to gain design wins, the firm did not expect that to happen until the
2 first quarter of 2010.

3 144. The touted lack of competition was an important metric for investors
4 in making their investment decision. Obviously it is less risky to invest in a
5 company whose flagship product enjoys a monopoly than one whose sales may be
6 eroded by competition. This is borne out by the market reaction to the September
7 17, 2009 news—the one day decline in the stock price was over 16%.

8 145. As B. Riley & Co. recognized in a September 25, 2009 analyst report,
9 “investors have sheared nearly 32% off STEC’s market cap, spurred by recognition
10 of encroaching competition from both established SSD players and new entrants to
11 the market.”

12 **F. After The Exchange Act Defendants Artificially Inflate The Price**
13 **Of STEC Stock, Defendants Manouch And Mark Moshayedi**
14 **Engage In Massive Insider Selling**

15 146. After falsely fueling an extraordinary rise in the price of STEC stock
16 from \$4 per share in December 2008 to \$35.50 per share on August 3, 2009 – an
17 increase of nearly 900% – Defendants Manouch and Mark Moshayedi timely
18 unloaded nine million shares of STEC common stock.

19 147. This sale reaped a windfall for the Company’s top executives of
20 *\$267.8 million in a single day*. Manouch and Mark Moshayedi’s collective
21 ownership of the Company decreased from 35.5% to 17.4%. Their brother, Mike
22 Moshayedi sold \$25 million of his stock in June and July 2009, beginning the day
23 after STEC’s June 16, 2009 announcement of increased sales of ZeusIOPS.
24 Within one week after the announcement, STEC’s former President unloaded over
25 one million shares.

26 148. The Moshayedis’ Class Period stock sell-off was the biggest insider
27 stock liquidation in the history of STEC. Defendant Manouch Moshayedi sold no
28 stock in 2008 and sold only 400,000 shares in March 2009 for proceeds of \$3

1 million. Mark Moshayedi sold only 466,292 shares in June 2008 and another
2 400,000 shares in March 2009, for proceeds of \$6.5 million and \$3 million,
3 respectively. The number of shares sold by the Moshayedis in the Offering was
4 collectively more than 11 times the number of shares they sold in the six months
5 before the Class Period and nearly 20 times the number of shares they sold in all of
6 2008.

7 149. After the market eventually learned that the EMC Supply Agreement
8 was in fact a one time deal, one analyst aptly observed, *“Whether management
9 knew about the demand/inventory issue in advance or not, the market found it
10 too coincidental that top management made such a substantial sale of stock in
11 the very quarter they blew up.”*

12 150. Following STEC’s November 3, 2009 announcement that the EMC
13 Supply Agreement would not order additional product in the first quarter of 2010,
14 the SEC instituted a formal investigation into insider trading at STEC. The
15 Company’s 2009 Form 10-K revealed for the first time: “The [SEC] is conducting
16 a formal investigation involving trading in our securities. Certain of our officers
17 and employees, including our CEO and President, have received subpoenas in
18 connection with the SEC’s investigation.”

19 **VI. ADDITIONAL ALLEGATIONS OF SCIENTER**

20 **A. Each Of Defendants’ False Statements And Omissions**
21 **Involved A Core Operation Of STEC**

22 151. Each of the false statements alleged herein involved a core operation
23 of STEC.

24 152. Each of the Individual Defendants was a top executive involved in
25 STEC’s daily operations and with access to all material information regarding the
26 Company’s core operations.

27 153. Therefore, each of the Individual Defendants is presumed to have had
28 knowledge of all material facts regarding such core operations.

1 154. STEC referred to ZeusIOPS as its “signature” product including when
2 Raymond Cook referred to ZeusIOPS during the August 3, 2009, conference call.

3 155. During the August 3, 2009, conference call, Defendant Manouch
4 Moshayedi stated that STEC was forecasting total third quarter revenue “between
5 \$95 million and \$97 million,” and ZeusIOPS revenue between “\$67 million to \$68
6 million.” Therefore, STEC was forecasting ZeusIOPS revenue for the 2009 third
7 quarter to comprise between 69% and 72% of all of STEC’s revenue.

8 156. EMC was STEC’s principal customer. During the November 3, 2009,
9 conference call, Defendant Manouch Moshayedi stated “EMC still remains our top
10 customer” and that EMC accounted for 90% of ZeusIOPS sales.” According to
11 STEC’s Form 424B3 filed on August 3, 2009, during the second quarter of 2009,
12 EMC accounted for 38.9% of all STEC’s revenues.

13 157. STEC considered its four OEM customers other than EMC to be
14 potentially as important to STEC as EMC. Thus, during the August 3, 2009,
15 conference call, Manouch Moshayedi referred to the five OEM customers,
16 including EMC, as “low hanging fruit,” and stated that “[w]e’ve only picked one
17 fruit at this point, and there are four more fruits left.”

18 158. STEC marketed itself to investors as, first and foremost, a “growth”
19 company—*i.e.*, a company producing steady revenue growth. Thus, in each of its
20 10-Q’s filed during the Class Period, STEC states at an early point in
21 “Management’s discussion and analysis of financial condition and results of
22 operations” that STEC is “focusing on certain revenue growth initiatives.” Thus,
23 in its earnings releases for each of the first three quarters in 2009, in order to stress
24 the continuing growth of its revenues, STEC compare its quarterly revenues, not
25 only to its revenues from the previous year’s same quarter, but also to its revenues
26 from the most recent previous quarter. STEC posted on its website an article by
27 Paul Shread, published on August 4, 2009, stating that “[t]he most interesting
28 detail to come out of STEC’s quarterly earnings report last night [*i.e.*, on August 3,